Internal Revenue Service

memorandum

CC:TL-N-7355-89
Br2:LSMannix

date: SEP 1 1989

to: Regional Counsel, Southeast Region CC:SE
Attn: Albert L. Sandlin, Jr., Special Trial Attorney

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: [redacted]

This responds to your request for Tax Litigation advice, dated June 2, 1989. This case has been scheduled for trial on October 23, 1989.

ISSUE

Whether a Federal Communications Commission (FCC) station license constitutes a franchise for purposes of I.R.C. § 1253.

CONCLUSION

A FCC station license is not a franchise for purposes of section 1253. The legislative history shows that Congress intended section 1253 to apply to a specific kind of arrangement, exemplified by the Dairy Queen cases. A station license is not such an arrangement.

FACTS

According to your request for advice, the petitioner acquired the assets of [redacted] and [redacted] on [redacted]. Of the $[redacted] purchase price, the petitioner originally allocated $[redacted] to goodwill. Now, however, the petitioner claims that the $[redacted] should be allocated to the FCC station license and amortized under section 1253 over a 10 year period.

DISCUSSION

Background

Every radio and television station located within the territorial United States must have a license granted by the FCC permitting the station to broadcast. 47 U.S.C.A § 301 (Supp. 1989); Red Lion Broadcasting Company v. FCC, 395 U.S. 367, 389 (1969).

47 U.S.C.A. § 301 states, in part:

> It is the purpose of this chapter [Title III of the Communications Act of 1934], among other things, to maintain the control of the United States over all channels of radio transmissions; and to provide for the use of such channels, but not the ownership thereof, by persons for limited periods of time, under licenses granted by Federal authority and no such license shall be construed to create any rights, beyond the terms, conditions, and periods of the license.

With respect to 47 U.S.C.A. § 301, the Supreme Court stated: "The policy of the Act [the Communications Act of 1934] is clear that no person is to have anything in the nature of a property right as a result of the granting of a license." FCC v. Sanders Brothers Radio Station, 309 U.S. 470, 475 (1939), cited in, Ashbacker Radio Company v. FCC, 326 U.S. 327, 331 n. 6. The United States Court of Appeals, District of Columbia Circuit, stated: "A license [a FCC station license] is merely a temporary permission to make use of rights belonging to the public, and confers no proprietary interest." MG-TV Broadcasting Company v. FCC, 408 F.2d 1257, 1264 n. 21 (D.C. Cir. 1968), citing Crowder v. FCC, 399 F.2d 569 (D.C. Cir. 1968).

Warren E. Burger, as a judge on the U.S. Court of Appeals, District of Columbia Circuit, stated:

> A broadcaster seeks and is granted the free and exclusive use of a limited and valuable part of the public domain; when he accepts that franchise it is burdened with enforceable public obligations .... After nearly five decades of operation the broadcast industry does not seem to have grasped the simple fact that a broadcast license is a public trust subject to termination for breach of duty.

Office of Communications of the United Church of Christ v. FCC, 359 F.2d 994, 1003 (D.C. Cir. 1966).

Because a FCC license does not confer property rights, it cannot be subject to a mortgage, lien, pledge, attachment or similar interest. 47 C.F.R. § 73.1150; Kirk Merkley, Receiver, 54 R.R.2d 68 (1983); Kirk Merkley, Receiver, 56 R.R.2d 413 (1984).

A FCC station license can be transferred only with the permission of the FCC. 47 U.S.C.A. § 310(d) states, in part:

> No construction permit or station license, or any rights thereunder, shall be transferred, assigned, or disposed of in any manner, voluntarily or involuntarily, directly or indirectly, or by transfer of control of any

> corporation holding such permit or license, to any person except upon application to the Commission [FCC] and upon finding by the Commission that the public interest, convenience, and necessity will be served thereby.

In this context, "trafficking" in station licenses, i.e., the acquiring of a license with the intent to sell it rather than to operate a station, is forbidden as against the public's interest and is grounds for denial or revocation of a license. Crowder v. FCC, supra. The Court in Crowder based its decision partly on the fact that a station license is not property belonging to a licensee but to the public. Id. at 571.

The FCC, in considering an application for either a new station license or the transfer of an existing license must determine "whether the public interest, convenience, and necessity will be served by the applicant" or transferee. 47 U.S.C.A. §§ 309(a) and 310(d). [1] Factors that the FCC may consider in determining whether the public interest will be served are:

> the citizenship, character, and financial, technical, and other qualifications of the applicant [or transferee] to operate a station; the ownership and location of the proposed station...; the frequencies and the power desired to be used; the hours of the day or other periods of time during which it is proposed to be used; and such other information as it may require.

47 U.S.C.A. § 308(b). These factors are discussed below.

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[1] With respect to a transfer of a license, the FCC cannot consider whether the public interest would be better served by a person other than the proposed transferee. 47 U.S.C.A. § 310(d). Thus, comparative review of competing applications for mutually exclusive licenses would not occur in the context of a transfer of a license. For a discussion of comparative hearings in the context of initial applications for, or renewals of, FCC licenses, see West Michigan Broadcasting Company v. FCC, 735 F.2d 601, 603-607 (D.C. Cir. 1984); Central Florida Enterprises, Inc. v. FCC, 598 F.2d 37, 40-44 (D.C. Cir. 1978), cert. dismissed, 441 U.S. 957 (1979); Formulation of Policies and Rules Relating to Participants in the Comparative Renewal Process, 66 R.R.2d 708 (1988). (In this context it should be noted that the FCC is currently considering the use of random selection lottery procedures for new AM, FM and television Station licenses, under 47 U.S.C.A. § 309(i), for equally qualified applicants instead of the current comparative hearing process. Selection of Station Licenses by Lottery, FCC Docket No. 89-15.)

With respect to the first factor, 47 U.S.C.A. § 310(d) prohibits aliens or foreign governments, or their representatives, from holding station licenses or controlling persons who hold station licenses. Factors relevant in determining the character of the applicant or transferee include certain criminal and civil violations and misrepresentations made before any governmental unit that resulted in sanctions. See Character Qualifications, 59 R.R.2d 801 (1985), recon. den'd, 61 R.R.2d 619 (1986). The applicant or transferee must also show financial and technical wherewithal to construct and/or operate a station.

47 C.R.R. § 73.3555 contains rules with respect to multiple ownership of broadcast stations. Included in the regulation are prohibitions against owning or controlling more than one broadcast station in the same market and owning or controlling a broadcast station and a newspaper in the same market. 47 C.F.R. § 73.3555. But see Cross-Interest Policy, 65 R.R.2d 1734 (1989) (Relaxation of the rule prohibiting individuals or entities from having an interest in a broadcast station and a media consulting firm, time brokerage firm or advertising firm); Multiple Ownership of Broadcast Facilities (Radio Doupoly Rule), 65 R.R.2d 1676 (1989) (Relaxation of the rule prohibiting ownership of more than one radio station in the same market); Broadcast Multiple Ownership Rules, 65 R.R.2d 1589 (1989) (Relaxation of the rule prohibiting cross ownership of radio and TV stations in the same market). The FCC also considers integration of ownership with management, place of residence, involvement in civic activities and minority ownership to be factors in comparative hearings for mutually exclusive licenses. See West Michigan Broadcasting Company v. FCC, supra; Winter Park Communications v. FCC, 66 R.R.2d 575 (D.C. Cir. April 21, 1989).

With respect to location, frequency, power and hours of operation, 47 U.S.C.A. § 307(b) requires that the FCC "make such distribution of licenses, frequencies, hours of operation, and of power among the several States and communities as to provide a fair, efficient, and equitable distribution of radio service to each of the same." With respect to the granting of AM station licenses, the mandate of 47 U.S.C.A. § 307(b) is met on a case by case basis. "...Where two or more mutually exclusive applicants have specified different communities of license, the FCC must determine the relative need to each applicant's proposed service area for a new reception service and the relative need of each applicant's community of license for a new transmission service." New Radio Corporation v. FCC, 804 F.2d 756, 757 (D.C. Cir. 1986). [2]

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[2] The 47 U.S.C.A. § 307(b) mandate is also met by the "go-no go" method of granting AM station licenses. Comparative Renewal

With respect to FM radio stations and Television stations, the mandate of 47 U.S.C. § 307(b) is met by the Table of Allotments under 47 C.F.R. §§ 73.202 and 73.606. Comparative Renewal Proceedings: Section 307(b) Issues, 62 R.R.2d 276 (1987). These tables allocate specific frequencies to various communities throughout the United States and its territories. Normally, no application for a FM or TV station will be considered by the FCC unless the application designates a frequency in a community specified in the tables. Logansport Broadcasting Corporation v. United States, 210 F.2d 24 (D.C. Cir. 1954). See Amendment of Part 73 to Provide an Additional FM Station Class, 66 R.R.2d 338 (1989); North Texas Media, Inc. v. FCC, 778 F.2d 28 (D.C. Cir. 1985); Communications Investment Corporation v. FCC, 641 F.2d 954 (D.C. Cir. 1981); Reeder v. FCC, 865 F.2d 1298 (D.C. Cir. 1989); WITN, Inc. v. FCC, 849 F.2d 1521 (D.C. 1988). [3]

In effect, the FCC has a broad scope for determining which factors it will take into account to ensure that the public interest will be served. Black Citizens for a Fair Media v. FCC, 719 F.2d 407 (D.C. Cir. 1983). However, the FCC does not generally take into consideration the type of programming that would be offered by the applicant or transferee. Black Citizens for a Fair Media, supra; FCC v. WNCN Listeners Guild, 450 U.S. 582 (1981); Committee to Save WEAM v. FCC, 808 F.2d 113 (D.C. Cir. 1986). Whether the FCC could make such an inquiry is doubtful. 47 U.S.C.A. § 326 states:

> Nothing in this chapter [Title III of the Communications Act] shall be understood or construed to give

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Proceedings: Section 307(b) Issues, 62 R.R.2d 276 (1987). Pursuant to this method, before an application for an AM station license will be considered, an applicant must show that the proposed station can be operated without causing or receiving objectional interference as defined in 47 C.F.R. § 73.37(a). AM Station Assignment Standards, 2 R.R.2d 1658 (1964), recon. den'd, 4 R.R.2d 1567 (1965); Review of Technical Assignment Criteria for the AM Broadcast Service, 52 F.R. 31795 (August 17, 1987). Thus, applications for new AM station licenses will tend to be for areas with little or no AM radio service. 62 R.R.2d 276. See Enhanced Night Time Operations for Class II-S and Class III-3 AM Radio Broadcast Stations, 53 F.R. 45524 (November 4, 1988); Loyola University v. FCC, 670 F.2d 1222 (D.C. Cir. 1982).

[3] Interference between FM stations and between TV stations is avoided by the allocation of frequencies in the Table of Allotments and by regulations in 47 C.F.R. Subparts B and D, which require minimum spacing between stations and designate power and antenna heights.

> the Commission the power of censorship over the radio communications or signals transmitted by any radio station, and no regulation or condition shall be promulgated or fixed by the Commission which shall interfere with the right of free speech by means of radio communications.

The Supreme Court in Sanders Brothers Radio Station, 309 U.S. at 475 stated: "But the Act does not essay to regulate the business of the licensee. The Commission is given no supervisory control of the programs, of business management or of policy." See also Columbia Broadcasting Systems, Inc. v. Democratic National Committee, 412 U.S. 94 (1973).

In this context, it should be noted that, for years, the FCC required radio and television stations to devote a substantial amount of air time to noncommercial programing, i.e., programing that addressed public issues of concern to the local community. FCC approval was also required for changes in programming format, whether or not the change occurred in the context of a transfer of a license. These requirements have now been substantially eliminated. See Deregulation of Radio, Report and Order, 49 R.R.2d 1 (1981), recon. den'd, 60 R.R. 526 (1986), aff'd in part, United Church of Christ v. FCC, 707 F.2d 1413 (D.C. 1983); FCC v. WNCN Listeners Guild, supra; Committee to Save WEAM v. FCC, supra; Black Citizens for a Fair Media, supra; Deregulation of Television, Report and Order, 56 R.R.2d 1005 (1984), recon. den'd, 60 R.R.2d 526 (1986).

Furthermore, the FCC revoked the fairness doctrine. Commission's Rules and Regulations Concerning the General Fairness Doctrine Obligations of Broadcast Licenses, 58 R.R.2d 1137 (1985), aff'd, Syracuse Peace Council v. FCC, 867 F.2d 654 (D.C. 1989). Thus, the limited content regulation that existed before such deregulation has all but vanished.

However, it should also be noted that the FCC recently imposed even more stringent rules with respect to indecent broadcasts. See New Indecency Enforcement Standards to be Applied to All Broadcast and Amateur Radio Licensees, 62 R.R.2d 1218 (1987), aff'd in part, Action for Children's Television v. FCC, 852 F.2d 1332 (D.C. Cir. 1988).

With respect to the granting of a station license, the Supreme Court, in Sanders Brothers Radio Station, supra, also stated:

> Plainly it is not the purpose of the Act to protect a licensee against competition but to protect the public. Congress intended to leave competition in the business of broadcasting where it found it, to permit a licensee who was not interfering electrically with other broadcasters to

> survive or succumb according to his ability to make his program attractive to the public.

Id. at 475. The Court went on to state: "We conclude that economic injury to an existing station is not a separate and independent element to be taken into consideration by the Commission in determining whether it shall grant or withhold or license." Id. at 476.

FCC licenses granted to television and radio stations cannot be in excess of 5 years and 7 years, respectively. 47 U.S.C.A. § 307(c). The FCC may grant renewals of licenses, upon applications therefor, to television and radio stations, for a period also not in excess of 5 years and 7 years, respectively. With respect to any renewal, the FCC must again consider whether the "public interest, convenience, and necessity would be served thereby." 47 U.S.C.A. § 307(c).

However, the FCC may and, in fact, does follow an abbreviated procedure for the renewal of licenses. 47 U.S.C.A. § 307(c); Black Citizens for a Fair Media; supra. Although, in a comparative hearing, the FCC cannot give per se preference to incumbent licensees, Central Florida Enterprises, Inc. v. FCC, supra, "renewal expectancy" is a factor weighed along with other factors in determining whether to renew an incumbent's license. Central Florida Enterprises, Inc. v. FCC, 683 F.2d 503 (D.C. Cir. 1982), cert. denied, 460 U.S. 1084 (1983). An incumbent "who rendered meritorious service can be reasonably confident of renewal." In re application of Dena Pictures, Inc., 56 R.R.2d 252 (1984).

47 U.S.C.A. § 312 states that the FCC may revoke a station license for any of the following reasons.

> (1) for false statements knowingly made either in the application or in any statement of fact which may be required pursuant to section 308 of this title;
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> (2) because of conditions coming to the attention of the Commission which would warrant it in refusing to grant a license or permit on an original application;
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> (3) for willful or repeated failure to operate substantially as set forth in the license;
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> (4) for willful or repeated violation of, or willful or repeated failure to observe any provision of this chapter or any rule or regulation of the Commission authorized by this chapter or by a treaty ratified by the United States;

(5) for violation of or failure to observe any final cease and desist order issued by the Commission under this section;

(6) for violation of section 1304, 1343, or 1464 of Title 18;[4] or

(7) for willful or repeated failure to allow reasonable access to or to permit purchase of reasonable amounts of time for the use of a broadcasting station by a legally qualified candidate for Federal elective office on behalf of his candidacy.

The Court of Appeals, District of Columbia Circuit, held that the "clear and convincing" evidence standard of proof is required for all revocations of FCC licenses. Sea Island Broadcasting of South Carolina v. FCC, 627 F.2d 240 (D.C. Cir. 1980). In other words, a station license can only be revoked for cause.

The FCC does not charge a fee for either granting a station license or for granting permission to assign a license. Neither does the FCC demand either an annual fee or a fee based on use. In short, the FCC does not charge any kind of fee that can be termed a franchise fee or a fee for the right to franchise. This is consistent with the fact that a licensee does not obtain a property interest in the license.

However, the FCC charges application fees to cover its cost in processing various kinds of applications. The application fee for a new license is $325.00 for an AM station and $100.00 for a FM station. The fee for an application for the assignment of a radio station license is $70.00 for the short form. The fee for an application for the renewal of a radio station license is $30.00. See Fees for Processing Applications, 62 R.R.2d 303 (1987); FCC Clarifies Fee Collection Procedures, 64 R.R.2d 262 (1987).

The actual terms and conditions of a station license are minimal. Included in the license are requirements that the station operate on a designated frequency and at a specific power level. Furthermore, the station's transmitting antenna must be at a designated spot and be a specific height. There are also other engineering and structural requirements for the transmitting antenna. See 47 C.F.R. Part 73.

Pursuant to 47 U.S.C.A. § 317, a broadcast station is also required to identify, at the time of the broadcast, any person

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[4] 18 U.S.C.A. §§ 1304, 1343 and 1464 address, respectively, advertisement of lotteries, other than state run lotteries; fraud by wire, radio or television; and broadcasts of obscene language.

who paid, or furnished valuable consideration to, the station for broadcasting any matter, including political advertisements.

The call signs for stations are picked by license applicants or transferees from a range of letters, on a first come, first serve basis. (KAAA-KZZZ for stations west of the Mississippi River and WAAA-WZZZ for stations east of Mississippi River.) The FCC will allocate a call sign to a new station only if the applicant fails to request a sign within the prescribed period. 47 C.F.R. §§ 2.301 and 73.3550. A broadcast station is required by the FCC to identify itself by its call letters at regular intervals. 47 C.F.R. § 73.1201.

Finally, although a station license gives the licensee the exclusive right to use a particular frequency within a designated area, it is not an exclusive grant to operate a broadcast station. More than one station can operate in a community without causing or receiving interference and in most communities there are a number of stations in operation competing with one another for a share of the market. See FCC v. WNCN Listeners Guild, supra; Committee to Save WEAM v. FCC, supra; Black Citizens for a Fair Media, supra. In fact, competition among stations has always been favored and is the basis for the FCC's most recent round of deregulation. Id. Specifically, the FCC decided that, because of the tremendous growth in competition, regulation of the broadcasting industry is best left to market forces. Id. Thus, a FCC station license is not an exclusive grant.

Statement of the Issue

The tax issue arises here when a broadcast station sells its business to a third party (hereinafter referred to as a "taxpayer"). Among the assets sold is the FCC station license. Taxpayers are allocating a portion of the purchase price to the station license and are amortizing this cost over the 10 year period prescribed in section 1253(d)(2)(A).

In order to avail itself of section 1253(d)(2)(A), taxpayers must use Rev. Rul. 88-24, 1988-1 C.B. 306. Otherwise, under section 1253(a), the sale would be deemed a sale or exchange of a capital asset because the selling broadcast station has not retained any significant power, right or continuing interest in the franchise. Thus, under a literal reading of the statute, the taxpayer could only amortize the cost of the franchise if it had an ascertainable useful life.

Rev. Rul. 88-24, however, allows taxpayers to amortize the cost of franchises under section 1253(d)(2)(A) if the franchiser retains any significant power, right or continuing interest, as defined in section 1253(b)(2), in the franchise. Taxpayers are arguing, among other things, that the FCC retains significant powers, rights and continuing interests in the station license because it retains the right to disapprove any assignment of the station license (section 1253(b)(2)(A)) and to prescribe the standards of quality of services furnished (section 1253(b)(2)(C)).

However, section 1253 only applies to a "franchise" as defined in section 1253(b)(1). Thus, the initial question is whether a FCC station license is a "franchise" as defined by section 1253(b)(1).

Legal Analysis

I. Legislative history should be examined in order to determine whether Congress intended section 1253 to apply to FCC station licenses.

There are certain litigation hazards in connection with arguing that a station license is not a "franchise" as defined in section 1253(b)(1) and is, therefore, not within the scope of section 1253. These hazards stem from a direct reading of section 1253. However, legislative history should be examined to determine whether Congress intended section 1253 to apply to FCC station licenses.

Section 1253(b)(1) states: "The term 'franchise' includes an agreement which gives one of the parties to the agreement the right to distribute, sell, or provide goods, services, or facilities, within a specified area."

Section 7701(c) states: "The terms 'includes' and 'including' when used in a definition contained in this title [the Internal Revenue Code] shall not be deemed to exclude other things otherwise within the meaning of the term defined." Thus, under a literal reading of section 1253(b)(1), an "agreement which gives one of the parties to the agreement the right to distribute, sell, or provide goods, services, or facilities, within a specified area" is within the meaning of the term "franchise" as used in section 1253(b)(1) and "other things otherwise within the meaning of the term..." are within the term "Franchise," as used in section 1253(b)(1).

Taxpayers are likely to argue that a station license is, in essence, an agreement which gives the licensee the right to provide services within a specified area and, thus, a station license falls within the literal definition of a "franchise" in section 1253. If it is assumed that a station license is, in essence, such an agreement, it would appear that recourse to the legislative history of section 1253 would be barred by the general rule of statutory construction which prohibits reference to legislative history if a statute is unambiguous on its face. See Gilbert v. Commissioner, 241 F.2d 491 (9th Cir. 1957); Flex-

O-Glass, Inc. v. United States, 3 AFTR2d 1034 (N.D. Ill. 1959). Thus, taxpayers will likely argue that the analysis ends here.

Furthermore, taxpayers are likely to argue that a station license is a public franchise and, thus, would be a thing otherwise within the meaning of the term "franchise."

However, notwithstanding these arguments, recourse may still be made to the legislative history of section 1253 in order to determine whether Congress intended section 1253 to cover station licenses. There is an exception to the general rule that if a statute is unambiguous on its face, recourse may not be made to its legislative history. In Lartobe Steel Company v. Commissioner, 62 T.C. 456, 462 (1974), the Tax Court stated:

> Although a literal interpretation of the first sentence of section 404(a) would appear to support the position of respondent, we are not confined to such a literal reading in order to construe the intended meaning of this section. Rather, it is our duty to give effect to the intent of Congress by interpreting the general words of a section with reference to the whole statute, the purpose for which it was enacted, and its antecedent history. Helvering v. N.Y. Trust Co., 292 U.S. 455 (1934). * * *

In Lartobe Steel, the Tax Court construed the statutory language at issue more narrowly than a literal interpretation would have warranted, after a review of the legislative history. In a more recent case, the Tax Court stated:

> In addition, we may seek out any reliable evidence as to the legislative purpose even where the statute is clear. United States v. American Trucking Associations, Inc., 310 U.S. 534, 543-544 (1940); U.S. Padding Corp. v. Commissioner, [88 T.C. 177, (1987) aff'd, 865 F.2d 750 (6th Cir. 1989)]; Estate of Baumgardner v. Commissioner, 85 T.C. 445, 451 (1985); Huntsberry v. Commissioner, 83 T.C. 742, 747-748 (1984); J.C. Penney Co. v. Commissioner, [37 T.C. 1013, 1019 (1962), aff'd, 312 F.2d 65 (2d Cir. 1962)].

Centel Communications Company, Inc. v. Commissioner, 92 T.C. No. 34 (March 23, 1989). The purpose of this exception to the general rule is to give effect to the legislature's intent, which is the first and most important rule of statutory interpretation. Helvering v. N.Y. Trust Co., 292 U.S. 455, 464 (1934).

Therefore, even though section 1253(b)(1) may be unambiguous on its face, recourse may still be made to the legislative history in order to determine whether Congress intended section 1253 to cover station licenses. And, upon examination of the legislative history, it will become clear that Congress intended section 1253 to cover a specific kind of arrangement that does not include a station license.

Alternatively, Sutherland Stat. Const. § 45.02 (4th Ed.) permits examination of the legislative history to section 1253 in the instant case. It states:

> A frequently encountered rule of statutory interpretation asserts that a statute, clear and unambiguous on its face, need not and cannot be interpreted by a court and that only statutes which are of doubtful meaning are subject to the process of statutory interpretation. ...However, this rule is deceptive in that it implies that words have intrinsic meaning. A word is merely a symbol which can be used to refer to different things. For example the word "automobile" has fairly determinate content and is not likely to cause great difficulty in interpretation; but the word "bill" may refer to an evidence of indebtedness, to currency, to a petition, to a person's name, to the anatomy of a bird, a portion of a cap and a host of other objects, and may need "interpretation" and "construction." * * *
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> ...Before the true meaning of a statute can be determined where there is genuine uncertainty concerning its applications, consideration must be given to the problem in society to which the legislature addressed itself. Prior legislative consideration of the problem, the legislative history of the statute under litigation, and the operation and administration of the statute prior to litigation are of equal importance.
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> When a court declares a statute ambiguous, it asserts that some of the words used may refer to several objects and the manner of their use does not disclose the particular objects to which the words refer. [endnotes omitted]

In the instant case, there is a genuine ambiguity as to what the term "franchise" in section 1253(b)(1) refers because the term has two distinct and well defined meanings and it is unclear from the face of the statute whether Congress intended section 1253 to apply to both types of franchises or to just one, or the other, type of franchise. (The term franchise can refer to a public franchise or a private business franchise. Both types of franchises are discussed later.) Although section 1253(b)(1) attempts to define the term "franchise," it only makes reference to one type of arrangement and there is no other guidance as to what else is within its scope.

It should also be noted that the maxim of ejusdem generis (of the same kind, class or nature) applies in this case. The maxim holds that where specific words follow general ones, the general term is restricted to things that are similar to the things enumerated. Sutherland Stat. Const. § 47.17 (4th Ed.) Thus, under ejusdem generis, the term "franchise" would be restricted to things similar to the type of arrangement enumerated in section 1253(b)(1).

Because it is unclear what types of arrangements are within the scope of section 1253, it is necessary to consult the legislative history.

II. The legislative history shows that Congress intended section 1253 to apply to private business franchises of the type at issue in the Dairy Queen cases.

Congress enacted section 1253 in response to a line of cases commonly referred to as the "Dairy Queen" cases. Both the House and the Senate reports discuss and cite these cases. H. Rep. No. 413, 91st Cong., 1st Sess., 1, 160-163, 1969-3 C.B. 200, 300-301; S. Rep. No. 552, 91st Cong., 1st Sess., 1, 205-209, 1969-3 C.B. 423, 554-555. All the Dairy Queen cases involved the transfer of private business franchises. (All the cases cited by the House and Senate, except for two, involved actual Dairy Queen franchises.) All the franchises were exclusive distributorships limited to specific geographical areas.

The issue in each of the cases was whether there had been a sale or exchange of a capital asset or merely the transfer of a license in a franchise. If there was a sale or exchange, the transferror/taxpayer received capital gain treatment and if there was merely the transfer of a license, the transferror/taxpayer received ordinary income treatment.

In most of the cases the issue of whether there was a sale or exchange turned on the amount of control the transferror/taxpayer retained over the franchise. If the transferror/taxpayer retained significant control over the franchise, the courts held that there was merely a transfer of a license in a franchise and the transferror/taxpayer received ordinary gain treatment.

The issue in the Dairy Queen cases, as described above, is the issue addressed by section 1253. In fact, section 1253 addresses the question of whether there is a sale or exchange in the same manner that most of the Dairy Queen cases addressed the issue. Under section 1253, if the transferror retains any significant power, right or continuing interest over the franchise, there is merely a transfer of a license and the transferror receives ordinary income treatment.

With respect to the issue of whether a transferror retains any significant power, right or continuing interest in a franchise, both the House and Senate reports couch their discussion in terms that would only be applicable to a private business franchises of the type at issue in the Dairy Queen cases. The House Report states:

> The following are some examples of the types of powers or rights which have been retained by franchisors: (1) the franchisee may not move equipment obtained from the franchisor outside of the territory in which he may operate; (2) the franchisee must purchase specified equipment from the franchisor; (3) the franchisee is required to periodically supply specified information regarding his operations to the franchisor; (4) the manner in which the franchisee conducts his operations are subject to the approval of the franchisor, such as prohibiting the sale of certain products; and (5) the franchisor may withdraw the franchise if the franchisee fails to develop his territory.

The next paragraph of the report states:

> In other words, it would appear that the franchisor has reserved what may be regarded as an operational interest in the subfranchise if he participates in its management by conducting activities such as sales promotion (including advertising), sales and management training, employee training programs, holding of national meetings for franchisees, providing the franchisee with blueprints or formulas, and other forms of continuing assistance.

H. Rep. No. 413, supra., 1969-3 C.B. at 301. The Senate Report contains substantially the same language. S. Rep. No. 552, supra., 1969-3 C.B. at 555-556. Most of the quoted discussion would only apply to private business franchises and there are other parts of the reports that would also only be applicable to private business franchises. [5]

The original version of the bill which ultimately became section 1253 was passed by the House Ways and Means Committee. The bill defined a "franchise" as follows: "The term 'franchise' means a franchise, distributorship, or other like interest."

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[5] Furthermore, the discussion on the floor of the Senate emphasises the fact that section 1253 is aimed at private business franchises. Both Senator Sparkman and Senator Baker discussed the provision in terms that would only apply to franchises of the type at issue in the Dairy Queen cases. Both Senators also expressed the idea that the provision was meant to benefit small businesses. 115 Cong. Rec. S15720 (p. 37074) (daily ed. December 4, 1969); 115 Cong .Rec. S15837 (p. 37311) (daily ed. December 5, 1969).

With respect to this version, the Report of the House Ways and Means Committee states: "The term 'franchise' is defined by the bill to mean a franchise, distributorship, or other like interest. This would include subfranchises, subdistributorships, and other similar exclusive type contract arrangements to operate a trade or business." H. Rep. No. 413, supra, 1969-3 C.B. at 302.

The Senate Finance Committee adopted a different definition of the term "franchise" and its version ultimately became section 1253(b)(1). The Senate Finance Committee Report states:

> the term "franchise" includes an agreement which gives one of the parties to the agreement the right to distribute, sell, or provide goods, services, or facilities, within a specified area. This would include distributorships or other similar exclusive-type contract arrangements to operate or conduct a trade or business within a specified area, such as a geographical area to which the business activity of the transferee is limited by the agreement. However, the committee amendments provide that the new rules are not to apply to the transfer of a franchise to engage in a professional sport. * * * The House bill did not define "franchise" in detail, but would have applied [the new section] to professional sport franchises.

S. Rep. No. 552, supra, 1969-3 C.B. at 557. (Section 1253(e) specifically exempts sport franchises from the application of section 1253.)

The House and Senate Committees' discussion of the definition of a franchise, when taken in context, shows that Congress was attempting to define the type of franchise at issue in the Dairy Queen cases. The sentence: "This would include subfranchises, subdistributorships, and other similar exclusive type contract arrangements to operate a trade or business," in the House Report and the sentence: "This would include distributorships or other similar exclusive-type contract arrangements to operate or conduct a trade or business within a specified area, such as a geographical area to which the business activity of the transferee is limited by the agreement" in the Senate Report describe the franchises at issue in the Dairy Queen cases.

Furthermore, the version adopted by the Finance Committee and ultimately used in the statute was an attempt to describe the attributes of the Dairy Queen franchises rather than merely stating that section 1253 covers "franchises, distributorships, or other like interest," as was done by the House Committee. As stated by the Finance Committee, the House did not attempt to define a "franchise" in detail. The Finance Committee Report, on the other hand, states that its definition covers "distributorships or other similar exclusive-type contract arrangements to operate or conduct a trade or business within a specified area" or, in other words, the definition in the statute covers the type of franchise at issue in the Dairy Queen cases.

In addition, the phrase "distributorship or other similar exclusive-type contract" (emphasis supplied) in the Senate Report and the phrases " distributorship, or other like interest" and "subdistributorships, and other exclusive type arrangements" (emphasis supplied) in the House Report is evidence that Congress intended section 1253 to cover franchises essentially similar to the franchises in the Dairy Queen cases. This position is supported by the maxim ejusdem generis, discussed above.

The above analysis leads to the conclusion that Congress intended section 1253 to apply to private business franchises of the type that was at issue in the Dairy Queen cases. First, Congress enacted section 1253 in response to the Dairy Queen cases and used the same approach as was used in those cases. And, all the franchises in the Dairy Queen cases were private business franchises. Second, the discussion of the definition of a franchise in the committee reports, and the statutory definition, is essentially an attempt to define the franchises at issue in the Dairy Queen cases. Third, the phrase "distributorship or other similar exclusive-type contract" in the Senate Report and the phrases " distributorship, or other like interest" and "subdistributorships, and other exclusive type arrangements" in the House Report is evidence that Congress intended section 1253 to cover franchises essentially similar to the franchises in the Dairy Queen cases.

III. The type of private business franchises at issue in the Dairy Queen cases have several characteristics that distinguish them from a station license.

The type of franchise at issue in the Dairy Queen cases has several distinguishing characteristics. These characteristics have been incorporated into the definitions of a "franchise" adopted by the Federal Trade Commission (FTC) and various states with respect to franchiser disclosure rules and other rules relating to private business franchises. 16 C.F.R. § 436.1(a). See, for example, N.Y. Franchises Law § 681 (McKinney 1984); Del. Code Ann. tit. 6, § 2551 (1975). The FTC's definition, which is similar to the various state definitions (and which is notably similar to Congress' description of franchise in the legislative history to section 1253, quoted above), is substantially as follows:

> (a) The term "franchise" means any continuing commercial relationship created by any arrangement or arrangements whereby:

(1)(i)(A) a person (hereinafter "franchisee") offers sells, or distributes to any person other than a "franchisor" (as hereinafter defined), goods, commodities, or services which are:

(1) Identified by a trademark, service mark, trade name, advertising or other commercial symbol designating another person (hereinafter "franchisor"); or

(2) Indirectly or directly required or advised to meet the quality standards prescribed by another person (hereinafter "franchisor") where the franchisee operates under a name using the trademark, service mark, trade name, advertising or other commercial symbol designating the franchisor; and

(B)(1) The franchisor exerts or has authority to exert a significant degree of control over the franchisee's method of operation, including but not limited to, the franchisee's business organization, promotional activities, management, marketing plan or business affairs; or

(2) The franchisor gives significant assistance to the franchisee in the latter's method of operation, including, but not limited to, the franchisee's business organization, management, marketing plan, promotional activities, or business affairs; * * *

* * *

and

(2) The franchisee is required as a condition of obtaining or commencing the franchise operation to make a payment or commitment to pay to the franchisor, or to a person affiliated with the franchisor.

16 C.F.R. § 436.1(a).

This definition, the various state definitions and the characteristics of the franchises at issue in the Dairy Queen cases can be distilled down into three general characteristics. These are: (1) the franchisee is granted the right to engage in the business of distributing, selling, or providing goods, services, or facilities under a marketing plan or system prescribed in substantial part by the franchiser; (2) the operation of the business is associated with the franchiser's trademark, service mark, logo or other commercial symbol designating the franchiser; and (3) the franchisee is required to make one or more payments, directly or indirectly, to the franchiser.

When these characteristics are applied to a station license, it becomes clear that a station license is not the type of franchise envisioned by Congress as within the scope of section 1253. First, the FCC does not prescribe a marketing plan for the licensee and, as discussed above, the FCC does not control the content of the programming, which is the actual product being offered by the licensee. Furthermore, the FCC does not prescribe how a licensee should market its services or products, solicit customers or advertise. Second, there is no trademark or trade name associated with a station license. A station's call letters are not sold or conveyed by the FCC but, rather, are chosen by the licensee. And third, the FCC does not charge a franchise fee.

Therefore, under the above analysis, a station license is not a franchise within the scope of section 1253.

In this context, it should be noted that the only published Service document that defines a "franchise" is Rev. Rul. 87-63, 1987-2 C.B. 210. Rev. Rul. 87-63 holds that "a license agreement to receive computerized commodity trading suggestions does not constitute a franchise under section 1253 of the Code...." The revenue ruling states that the rationale for the holding is that Congress did not intend section 1253 to apply to this type of arrangement as evidenced by the Senate Finance Committee Report (quoted above). The revenue ruling states that Congress intended section 1253 "to apply to systems of distributions generally characterized by many or all of the traditional indicia of franchise arrangements. These include the continued use by the franchisee of the franchiser's trade name and trademarks, quality controls by the franchisers, management and operational guidance, and common advertising and promotion by the franchiser, within a specified area."

Rev. Rul. 87-63 assumes that the only type of franchise that is within the scope of section 1253 is a private business franchise of the type at issue in the Dairy Queen cases. As stated above, there is no use of the franchiser's trade name or trademark with a station license; the FCC does not control the content of the programming, which is, in fact, the product being provided by the licensee; and there is no management and operational guidance or common advertising and promotion with a station license. Thus, under Rev. Rul. 87-63, a station license is also not within the scope of section 1253.

IV. <u>Assuming, arguendo, that section 1253 covers public franchises, the FCC's grant to the broadcast station is a license and not a public franchise.</u>

As discussed above, a FCC station license is not the type of arrangement envisioned by Congress as being within the scope of section 1253. The argument is that when Congress used the phrase " a 'franchise' includes an agreement which gives one of the parties...the right to...provide goods [or] services...within a specified area" (section 1253(b)), it was describing a private business franchise of the type at issue in the Dairy Queen cases.

However, as stated above, taxpayers may argue that other arrangements otherwise within the term "franchise" are within the scope of section 1253. See section 7701(c). Taxpayers may argue that one such arrangement otherwise within the term "franchise" is public franchises and that a FCC station license is a public franchise.

A public franchise has been defined as follows:

> "A franchise is a right or privilege granted by the sovereignty to one or more parties to do some act or acts which they could not perform without this grant from the sovereign power. * * *
>
> "A right or privilege which is essential to the performance of the general function or purpose of the grantee, and which is and can be granted by the sovereignty alone, such as the right or privilege of a corporation to operate an ordinary or commercial railroad, a street railroad, city waterworks or gasworks, and to collect tolls therefor, is a franchise....
>
> "A right or privilege not essential to the general function or purpose of the grantee, and of such a nature that a private party might grant a like right or privilege upon his property, such as a temporary or revocable permission to occupy or use a portion of some public ground, highway, or street, is a license and not a franchise."

Community Tele-Communications, Inc. v. Heather Corporation, 677 P.2d 330, 337 (Colo. 1984), quoting, McPhee & McGinnity Company v. Union Pacific Railroad Company, 158 F. 5, 10 (8th Cir. 1907).

However, a grant from the sovereignty to a private person that is personal; temporary; for which no consideration is given; and in which no vested rights are obtained is a mere license and not a public franchise. City of Owensboro v. Cumberland Telephone & Telegraph Company, 230 U.S. 58, 64-66 (1913); Bank of Commerce v. Tennessee, 163 U.S. 416, 424-425 (1896); Pearsall v. Great Northern Railway, 161 U.S. 646, 660-668 (1896). The most important of these elements and the distinguishing feature of a public franchise is that a public franchise is a vested right which, absent a provision in the grant, cannot be altered or revoked without the consent of the franchisee. Id. See 36 Am. Jur.2d, Franchises, § 2 (1968); 37 C.J.S., Franchises, § 7 (1943).

A FCC station license is not property or a vested right and it is not owned by the licensee. 47 U.S.C. § 301; Sanders Brothers Radio Station, supra; Ashbacker Radio Company; supra; MG-TV Broadcasting Company, supra; Office of Communications of the United Church of Christ, 359 F.2d 994. A station license can be altered or revoked without the consent of the licensee. Federal Radio Commission v. Nelson Brothers Bond & Mortgage Company, 289 U.S. 266, 282 (1933); WITN-TV, Inc., 849 F.2d at 1523; Loyola University, supra; 47 U.S.C.A. § 312. A station license is also personal to the licensee because it can only be transferred with permission of the FCC and the FCC must examine the transferee as if he were the original licensee. 47 U.S.C.A. § 310(d). No consideration is given by the licensee for the license and a station license is temporary. 47 U.S.C.A. § 307(c). Thus, a FCC station license is not a public franchise but, rather, is merely a license.

Therefore, even if section 1253 applies to public franchises, a FCC station license is not within its scope because it is not a public franchise.

In this context it should be argued that references by then Judge Burger, in Office of Communications of the United Church of Christ v. FCC, 359 F.2d at 1003, (quoted above), the Court, in Evans v. American Federation of Television and Radio Artists, 354 F.Supp. 823, 839 (S.D. N.Y. 1973), and by the FCC, in a few cases, to a station license as a franchise should be treated as dicta because in none of those cases did the courts or the FCC address the issue of whether a FCC station license is a public franchise or a license.

V. Assuming, arguendo, that a FCC station license is a public franchise or an agreement to provide goods or services, it is not within the scope of section 1253 because it is not exclusive.

As quoted above, the House and Senate committee reports define the term "franchise" by stating that the term includes "...other similar exclusive type contract arrangements to operate a trade or business." H. Rep. No. 413, supra, 1969-3 C.B. at 302; S. Rep. No. 552, supra, 1969-3 C.B. at 557. The statute, itself, states that the term includes an agreement to provide goods or services "within a specified area." Section 1253(b)(1).

The import of these phrases is that Congress intended section 1253 to apply to exclusive territorial franchises or, in other words, to franchises pursuant to which the franchisee's territory is limited to a specified area. This is consistent with the above discussion because all the franchises at issue in the Dairy Queen cases were exclusive distributorships limited to specific geographical areas.

Applying the law to the instant case results in the conclusion that a station license is not within the scope of section 1253 because it is not an exclusive franchise. As discussed above, although a station license gives the licensee the exclusive right to use a particular frequency within a designated area, it is not an exclusive grant to operate a broadcast station. More than one station can operate in a community without causing or receiving interference and in most communities there are a number of stations in operation competing with one another for a share of the market. Thus, a station license is not an exclusive franchise and is not within the scope of section 1253.

VI. The contra argument is that a FCC station license should be treated like private business franchises for purposes of federal income taxation.

One case cited by both the Tax Court and the Fifth Circuit in the Dairy Queen case Moberg v. Commissioner, 35 T.C. 773, 784 (1961), aff'd, 305 F.2d 800, 804 (5th Cir. 1962), involved a public franchise. In that case, Jones v. United States, 96 F.Supp. 973 (D. Colo. 1951), aff'd, 194 F.2d 783 (10th Cir. 1952), the taxpayer sold his interest in a municipal bus franchise, which was held in a partnership, to the other partner. The issue was whether the taxpayer should receive capital gain or ordinary income treatment on the sale in light of the fact that he received compensation in the form of half the rent from a lease that existed on the bus franchise.

Although the courts' opinions in Jones is unclear, the courts in Moberg cite the Jones case for two propositions. The Tax Court cites the case for the proposition that merely because a transferror is a licensee does not bar the possibility of a sale, as opposed to a transfer of a mere license in a franchise. The Fifth Circuit cites the case for the proposition that capital gain treatment is not lost by providing for payments contingent on future sales. (Section 1253 now requires that such payments be ordinary income.)

The Jones case presents another significant litigation hazard with respect to the instant issue primarily because it stands for the proposition that the same issues that arose in the Dairy Queen cases and that led to the enactment of section 1253 can arise in the context of a public franchise or a FCC station license. And, there appears to be no reason not to apply the same principles that exist in section 1253 to the transfer of a FCC station license. This argument can be countered by arguing that the Jones case was not cited in the legislative history to section 1253 and, as shown above, Congress only considered private business franchises when it enacted section 1253.

RECOMMENDATION

For the reasons outlined above, the instant issue should be defended. Furthermore, the administrative importance of this issue is substantial. Because the term "franchise," pursuant to section 1253(b)(1), has not been defined by the courts, taxpayers are attempting to include a large variety of arrangements within its definition to take advantage of the amortization provided by section 1253(d)(2) and Rev. Rul. 88-24. The instant issue should be the Service's first line of defense against an overly broad definition of the term.

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